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EU Treaties require Eurozone monetary policy to take environmental objectives into account

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Abstract:
Article 11 TFEU (Treaty on the Functioning of the European Union) not only integrates environmental protection into the mandate of the Eurosystem, it also sets forth a procedural obligation to take such measures into account in the process of designing and implementing the Eurosystem's policies. A reply from the Bundesbank to a recent access to information request filed by the authors confirms that the Eurosystem continues to fall short of this obligation. This exposes the Eurosystem to considerable legal risk. This policy brief presents two proposals that would allow the Eurosystem to discharge its obligation under Article 11 TFEU. The Eurosystem could consider these proposals in its ongoing strategy review.

Highlights:

*** Article 11 TFEU imposes a procedural obligation on the Eurosystem to consider environmental protection when designing and implementing its policies.**

*** New evidence from the Bundesbank and public statements of ECB officials indicate that the Eurosystem continues to fall short of its obligations.**

*** Article 11 TFEU equips the Eurosystem with the power to promote environmental protection alongside price stability.**

*** The ECB should include climate objectives into its monetary policy and supervisory exercises.**

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1. The Eurosystem is not taking climate change into account

Article 11 TFEU requires that environmental protection objectives be integrated into all EU policies. This also applies to the Eurosystem when designing and implementing monetary policy. In particular, Article 11 TFEU imposes a procedural obligation on the Eurosystem to take into account environmental objectives in the process of designing and implementing monetary policy.[1]

On 9 December 2016, *The Guardian* reported on an analysis by Corporate Europe Observatory that revealed that the Eurosystem was purchasing bonds issued by corporations in the oil, gas and automotive industries as part of its Corporate Sector Purchase Programme (CSPP).[2]

These revelations sparked a political debate. Mr Mario Draghi, former President of the European Central Bank (ECB), was questioned on the issue on several occasions by the European Parliament.

1. Javier Solana, 'The Power of the Eurosystem to Promote Environmental Protection' (2019) 30 *European Business Law Review* 4 547, 557 <https://eprints.gla.ac.uk/168312/7/168312.pdf>.

2. Arthur Neslen, 'ECB's quantitative easing programme investing billions in fossil fuels', *The Guardian* (9 December 2016) <https://www.theguardian.com/environment/2016/dec/09/ecbs-quantitative-easing-programme-investing-billions-in-fossil-fuels>.

Article 11 TFEU (cross-sectional clause applying to all EU policies)		
	Significance	**Implications for (the Eurosystem's) policymaking**
Substantive dimension	**Environmental policy objectives** are incorporated into the mandates of EU institutions to be promoted alongside their specific objectives (substantive dimension).	The Eurosystem has to balance price stability against environmental policy objectives when designing and implementing monetary policy, leaving it with broad discretion in the fulfilment of its mandate.
Procedural dimension	**Environmental protection** needs to be taken into account in the **design and implementation of EU policies** (procedural dimension).	The CJEU has identified procedural obligations as a strict limit to the Eurosystem's broad discretion. Thus, compliance with Article 11 is essential to: 1. Assess whether the policy is suitable and necessary to achieve the intended objective (proportionality principle). 2. Enable a subsequent review (by the courts)[3]

In July 2018, Mr Draghi explicitly acknowledged that "[t]o my knowledge, we don't have an analysis of the impact of our programme or of climate change considerations in our programme, but I can certainly say that we will look into this and see what's the effect".[4] Mr Draghi's testimony was a rotund confirmation that the Eurosystem was falling short of its obligation under Article 11 TFEU.

On 1 November 2019, Ms Christine Lagarde succeeded Mr Draghi as President of the ECB - the same day that the Eurosystem restarted purchases under the CSPP with an unchanged implementation process. Ms Lagarde declared her intention to do things differently. Like Mr Draghi, she confirmed that the ECB's primary mandate was price stability yet added that "it has to be embedded in that that climate-change and environmental risks are mission critical [...]"[5] and further endorsed "a gradual transition to eliminate carbon assets".[6]

On 20 December 2019, we submitted requests to the German Bundesbank and the Spanish Banco de España to access certain information about their implementation process of the CSPP to confirm whether they had begun to take into account the impact of the programme on climate change. As of 30 April 2020, we had only received a response from the Bundesbank, which noted that "[i]n designing the CSPP, the Governing Council has so far neither laid down non-financial criteria nor instructed the Bundesbank to take such criteria into account in its implementation, i.e. environmental impacts or aspects of climate change". This statement confirms that the Eurosystem continues to fall short of discharging its obligation under Article 11 TFEU. This exposes the Eurosystem to considerable legal risk.[7]

2. Current purchases of green bonds are not enough to discharge the Eurosystem's obligation under Article 11 TFEU

On 8 November 2018, the ECB published specific details of the volume of green bonds that it holds in the CSPP portfolio.[8] Since then, the ECB has repeatedly referred to these purchases as an example of the ECB's commitment to

3. Case C-62/14, Gauweiler and others, EU:C:2015:400 (hereinafter, "Gauweiler"), para 69, 70. See also Case C-493/17, Weiss and others, EU:C:2018:1000 (hereinafter, "Weiss"), para 30, 31.
4. See Committee on Economic and Monetary Affairs, 'Transcript of the Monetary Dialogue with Mario Draghi, President of the ECB' (9 July 2018) <http://www.europarl.europa.eu/cmsdata/151460/Monetary%20dialogue%2009.07.2018_EN.pdf>.
5. See European Parliament Committee on Economic and Monetary Affairs, 'Public hearing with Christine Lagarde' (4 September 2019), p.10 <https://www.europarl.europa.eu/cmsdata/186683/CRE_Public%20hearing_Lagarde_04.09.2019-original.pdf>.
7. See Solana (n 1), 566.
8. See Roberto A De Santis and others, 'The Impact of the Corporate Sector Purchase Programme on Corporate Bond Markets and the Financing of Euro Area Non-Financial Corporations' (8 November 2018) *ECB Economic Bulletin, Issue 7 / 2018* <https://www.ecb.europa.eu/pub/economic-bulletin/focus/2018/html/ecb.ebbox201807_01.en.html>.

environmental protection.[9] But the mere presence of these bonds in the CSPP portfolio is not enough to discharge the Eurosystem's obligation under Article 11 TFEU.

In the event of an admissible challenge of the CSPP, based on the previous challenges to monetary policy programmes in *Gauweiler* and *Weiss* the CJEU would particularly focus on the Eurosystem's compliance with procedural obligations. In those decisions, the Court made it clear that there are certain procedural guarantees that must not be overstepped: **the duty to examine all relevant elements in the context of the decision**, and **the duty to state reasons for the decision**.[10]

The Eurosystem purchasing green bonds is not the result of a conscious decision to take climate change into account. Under the current CSPP, green bond purchases are the result of the Governing Council's "market neutrality approach", i.e. its decision to design the CSPP so as "to avoid undue market distortions and level playing field concerns".[11] In the words of Mr Draghi: "[T]he CSPP-eligible universe and purchases are deliberately broadly defined and do not positively or negatively discriminate on the basis of the issuers' economic activity, *which is also why we have not conducted any specific climate impact assessment*".[12] In fact, "[t]he Eurosystem has purchased several green bonds under the CSPP and the holdings of these bonds are broadly in line with their weightings in the benchmark".[13] In other words: the Eurosystem is purchasing green bonds because they fall within the universe of eligible assets that can be purchased under the CSPP, not because of their potential contribution to mitigating climate change. Indeed, only the complete disregard of climate change can explain the presence of green bonds in the CSPP portfolio alongside an immense volume of bonds issued by corporations whose activities contribute to aggravate climate change.[14]

Market neutrality cannot discharge the Eurosystem's obligation under Article 11 TFEU to take environmental protection objectives into account because it responds to a very different motivation. Discharging its obligation under Article 11 TFEU will require the Eurosystem to *actively engage* with environmental protection. Such an engagement should be evident in the ECB's decision-making process, for example by express references in key policy documents to the impact that the programme is going to have on climate change.[15] Only then will the CJEU be able to examine the different interests at stake, including the potential need to prioritise price stability.

3. How the Eurosystem might take climate change into account

Until the Eurosystem actively engages with the potential impact of its monetary policy measures on

9. ibid., cf. also: Committee on Economic and Monetary Affairs, 'Transcript of the Monetary Dialogue with ECB President' (9 July 2018), p. 16-18 <http://www.europarl.europa.eu/cmsdata/151460/Monetary%20dialogue%2009.07.2018_EN.pdf>; Committee on Economic and Monetary Affairs, 'Draft Report on the Council: recommendation on the appointment of the President of the European Central Bank' (C9-0048/2019 – 2019/0810(NLE)), p. 22, <www.europarl.europa.eu/meetdocs/2014_2019/plmrep/COMMITTEES/ECON/PR/2019/09-04/1187645EN.pdf>;
European Parliament Committee on Economic and Monetary Affair, 'Draft Report on the Council recommendation on the appointment of the President of the European Central Bank', p. 21 <https://www.europarl.europa.eu/meetdocs/2014_2019/plmrep/COMMITTEES/ECON/PR/2019/09-04/1187645EN.pdf>.
10. Gauweiler, paras. 69, 70; Weiss, paras. 30, 31.
11. See letter from Mr Draghi to Members of the European Parliament on 12 June 2018, p. 2 <https://www.ecb.europa.eu/pub/pdf/other/ecb.mepletter180615_Tang-Gill-Fernandez.en.pdf>; Committee on Economic and Monetary Affairs, 'Transcript of the Monetary Dialogue with ECB President' (26 November 2018), pp. 8-9 https://www.ecb.europa.eu/pub/pdf/annex/ecb.sp181126_2_transcript.en.pdf.
12. Ibid. (emphasis added.)
13. Ibid.

14. For detailed analyses of the CSPP and its climate impact, see Sini Matikainen and Others: 'The climate impact of quantitative easing' (2017) *Policy Paper, Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science* <http://www.lse.ac.uk/GranthamInstitute/wp-content/uploads/2017/05/ClimateImpactQuantEasing_Matikainen-et-al-1.pdf>; Stefano Battiston and Irene Monasterolo 'How could the ECB's monetary policy support the sustainable finance transition?' (2019) *Report, University of Zurich FINEXUS Center for Financial Networks and Sustainability* <https://www.finexus.uzh.ch/dam/jcr:0103ed7b-71e9-4e81-9941-ee61feefd851/ECB%20sustainable%20finance%2022%20MarchIM.pdf>. Various analyses on the adverse environmental impact of Eurosystem's monetary policy in general, as well as of CSPP, are also provided by Stanislas Jourdan and Wojtek Kalinowski, 'Aligning Monetary Policy with the EU's Climate Targets' (2019) *Policy Paper, Veblen Institute for Economic Reforms and Positive Money Europe* http://www.positivemoney.eu/wp-content/uploads/2019/04/Aligning-Monetary-Policy-with-EU%E2%80%99s-Climate-Targets.pdf; see also Jens van 't Klooster and Clément Fontan 'The Myth of Market Neutrality' (2019), *New Political Economy*, p. 9 <https://www.tandfonline.com/doi/pdf/10.1080/13563467.2019.1657077?needAccess=true>.
15. The documents that the CJEU will examine to assess compliance of the ECB's duty to state reasons are: (1) monetary policy decisions and subsequent amendments, (2) documents supplementing the reasoning given in the decision published at the time of the decision, e.g. press releases, introductory statements or answers to questions given by the President of the ECB at press conferences, or accounts of the ECB Governing Council's monetary policy meetings, and (3) documents published after the decision was adopted, in particular, the ECB's Economic Bulletin; see Weiss, paras. 34-40.

legal risk. We present two sets of suggestions that would help the Eurosystem discharge its obligation under Article 11 TFEU.

a. *Integration of an environmental impact assessment into the design of future monetary policy programmes*: Climate change poses risks for financial stability.[16] The quality requirements of eligible bonds under the CSPP could integrate these climate-related financial risks. For example, these risks could be reflected in the ratings that the Eurosystem relies on, either for collateral requirements or for purchases of assets under the APP. If existing ratings do not take these risks into account,[17] the Eurosystem could apply an environmental factor to correct them. The Eurosystem itself is exposed to these climate-related financial risks so it could also integrate them into its own internal risk control measures.[18]

b. *Integrate an environmental "watch group" established within the ECB into the decision-making process:* The Eurosystem could establish an independent expert group to provide advice on the impact that monetary policy could have on climate change. This expert group could provide helpful insights by submitting reports (e.g. on the expected environmental impact of envisaged policies) directly to the Governing Council of the ECB for their consideration within the policy making process. In that way, the Eurosystem would be able to demonstrate an active engagement with the environmental impact of its monetary policy and discharge its obligation under Article 11 TFEU. This group could also help to address any potential coordination problems between the ECB and NCBs in the implementation of monetary policy measures. In addition, it could support existing efforts that aim at deepening our understanding of climate-related financial risks such as those of the TCFD's and the NGFS.[19] For example, it could lead and facilitate dialogue with stakeholders such as issuers, banks, other central banks, and civil society organisations.

16. See NGFS, 'A call for action: Climate change as a source of financial risk' (April 2019) <https://www.ngfs.net/sites/default/files/medias/documents/ngfs_first_comprehensive_report_-_17042019_0.pdf>.
17. Financial markets do not necessarily reflect climate risks adequately, see e.g. NGFS, 'First Progress Report' (October 2018), p.9 <https://www.banque-france.fr/sites/default/files/media/2018/10/11/818366-ngfs-first-progress-report-20181011.pdf>; Pierre Monnin, 'Integrating Climate Risks into Credit Risk Assessment' (December 2018), *Discussion Notes, Council on Economic Policies* <https://www.cepweb.org/wp-content/uploads/2019/02/CEP-DN-Integrating-climate-risks-into-credit-risk-analysis.pdf>. However, some rating agencies consider a change in their practices and there are other constant developments in that regard, e.g. European Securities and Markets Authority (ESMA)'s new guidelines suggest that credit rating agencies report on whether they assess ESG risks alongside other credit risks <https://www.esma.europa.eu/press-news/esma-news/esma-advises-credit-rating-sustainability-issues-and-sets-disclosure>.
18. See Solana (n 1), 574; see also, specifically for the CSPP, Battiston and Monasterolo (n 14); Others demand the exclusion of certain assets, such as coal-related assets, from central bank balance sheets, see Frank van Lerwen 'Banking on Coal: How central banks can address the financial risks and support a capital shift away from coal' (2020), *New Economics Foundation*, pp. 12-16 <https://neweconomics.org/uploads/files/BankingOnCoal_200204_180818.pdf>.

4. Conclusion

Climate change compromises the economy and the society of the European Union. The less attention central banks continue to pay to the environmental impact of their monetary policy decisions, the greater the risks that climate change will pose for financial and price stability.

Article 11 TFEU imposes an obligation on the Eurosystem to take climate change and other environmental protection objectives into account when designing and implementing monetary policy; but, more importantly, it also integrates environmental protection into its mandate, thus conferring on the Eurosystem the power to act on climate change. In light of the strategy review recently launched by the ECB,[20] it is time for the Eurosystem to make climate change and environmental risks "mission critical". This review represents a unique opportunity for the ECB to mitigate the legal risks arising from Article 11 TFEU.

19. See Task Force on Climate-Related Disclosure (TCFD), 'Final report: Recommendations of the Task Force on Climate-related Financial Disclosure' (15 June 2017) <https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf>; Network for Greening the Financial System (NGFS), 'A call for action: Climate change as a source of financial risk' (April 2019) <https://www.ngfs.net/sites/default/files/medias/documents/ngfs_first_comprehensive_report_-_17042019_0.pdf>.
20. See ECB, 'Strategy Review' (20 January 2020) <https://www.ecb.europa.eu/home/search/review/html/index.en.html>.

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